LEGISLATIVE AUDIT COMMISSION

Review of
Illinois Student Assistance Commission
Two Years Ended June 30, 2003

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REVIEW: 4201
ILLINOIS STUDENT ASSISTANCE COMMISSION
TWO YEARS ENDED JUNE 30, 2003

FINDINGS/RECOMMENDATIONS - 9
NOT ACCEPTED - 1
PARTIALLY ACCEPTED - 1
ACCEPTED - 7

REPEATED RECOMMENDATIONS - 1

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 5

This review summarizes the audit of the Illinois Student Assistance Commission for the two years ended June 30, 2003, filed with the Legislative Audit Commission April 13, 2004. The auditors performed a financial and compliance audit in accordance with State law and Government Auditing Standards. The auditors stated that the financial statements were fairly presented.

The Illinois Student Assistance Commission was established through the Higher Education Student Assistance Law in 1957. Ten persons are appointed by the Governor to serve as Commission members without compensation for a term of six years, except for one member who serves for a term of two years. The Commission was created to establish and administer a system of financial assistance through loan guarantees, scholarships and grant awards for residents of the State of Illinois to enable them to attend qualified public or private institutions of their choice within Illinois.

Larry E. Matejka is the current Executive Director of the Commission. He has served in that capacity since 1989.

The average number of full-time equivalent employees was:

Division	2003	2002	2001
Executive	45	56	52
Client Relations	7	21	26
Claims & Collections	107	110	81
Program Services	94	92	82
Accounting Services	40	37	89
Management Information Services	59	61	58
Human Resources	10	10	16
Administrative Services	17	18	10
Total Full-time Employees	**379**	**404**	**414**
Full-time equivalent part-time employees	8	9	21
Illinois Designated Account Purchase			
Program employees	136	136	119
Total Employees	**523**	**549**	**554**

Expenditures From Appropriations

Appendix A presents a summary of appropriations and expenditures for the two-year period under review. The General Assembly appropriated $682,550,600 to the Illinois Student Assistance Commission in FY03: $280,413,700 from the General Revenue Fund; $102,368,300 from the Educational Assistance Fund; $299,768,600 from the Federal Student Loan Fund and other funds. This represents a $48.4 million, or 6.6%, decrease over FY02. The Commission expended a total of $573,316,031 in FY03, compared to $607,041,445 in FY02 and $603,172,874 in FY01. The overall 5% decrease in expenditures between FY02 and FY03 was generally in response to budget constraints and accomplished through reduced spending in almost every program.

Lapse period spending during FY03 was $14.2 million, or 2.3% of total expenditures. Delayed billing and delivery of products were the reasons for the majority of lapse period spending.

Cash Receipts

Appearing in Appendix B is a summary of cash receipts of the Commission during the period under review. Total cash receipts increased from $1,849,955,000 in FY02 to $2,627,237,000 in FY03, a 42% increase. Increases in receipts are due almost entirely to increased activity in the Designated Account Purchase Program related to increased demand for student loans and the maturity of investments.

Property and Equipment

Appearing in Appendix C is a summary of property and equipment transactions of the Illinois Student Assistance Commission during the period under review. The balance decreased from $16,306,000 as of July 1, 2002 to $15,799,000 as of June 30, 2003. Of the June 30, 2003 balance, $21,011,000 is in ISAC buildings and the underlying land.

Guaranteed Loan Program

The Illinois Student Assistance Commission guarantees loans for educational expenses made to Illinois residents by banks, savings and loans, and credit unions. The Commission has responsibility for eligibility verification, processing default payments and collection of defaulted loans. Under a reinsurance agreement, the federal government has assumed at least 95% of the cost of defaulted loans provided that default rates do not exceed established limits.

The Commission supplied the information for Appendix D which summarizes the guaranteed loans outstanding at the end of the fiscal years indicated. The amounts are overstated by unreported payments made directly to lenders. Accrued interest on loans is not included. Also shown is information on payments to lenders, notes receivable on defaulted loans and collections on defaulted loans.

Notes receivable from defaulted borrowers include all defaulted loans excluding death, bankruptcy and disability claims since the inception of the program. The amount is reduced by total collections on these loans since the inception. There is no provision for doubtful or uncollectible amounts.

Accounts Receivable

Accounts receivable for FY03 were $2,499,596,000 compared to $2,135,931,000 in FY02. The chart below details the amounts receivable in each category:

	2003	2002
Inter-governmental	$ 20,627,000	$ 26,702,000
Student loans	2,428,497,000	2,049,799,000
Accrued interest on loans	39,404,000	41,606,000
Accrued interest on investments	4,111,000	3,823,000
Other	6,957,000	14,001,000
TOTAL	**$ 2,499,596,000**	**$ 2,135,931,000**

Awards and Grants

The Illinois Student Assistance Commission administers a variety of nonrepayable financial assistance programs. A summary of these scholarships and grants awarded during the audit period appears in Appendix E. The number of awards decreased from 182,382 in FY02 to 176,252 in FY03. The amount of awards and grants decreased also from $409,593,163 in FY02 to $372,561,896 in FY03.

Illinois Designated Account Purchase Program

The Illinois Designated Account Purchase Program (IDAPP) is a self-supporting program whereby the Commission purchases guaranteed student loans from eligible lenders to reduce their lender collection and administrative costs. Generally, IDAPP does not purchase loans which are more than 90 days delinquent.

The Program is accounted for as a proprietary fund. At June 30, 2003, the fund had total assets of $3,356,837,332. The table appearing in Appendix F presents a statement of net assets at June 30, 2003 and 2002.

Appendix G presents a summary of revenues and expenditures for the Designated Account Purchase Program.

College Illinois!

College Illinois! is a prepaid tuition program approved in 1997 to provide Illinois families with an affordable tax-advantaged method to pay for college. Prepaid tuition contracts will allow participants to prepay the cost of tuition and mandatory fees at Illinois public universities and community colleges at today's prices. Benefits of the contracts can also be used at private and out-of-state colleges and universities. Contracts can be purchased in a lump sum payment or in installments.

Total assets in the prepaid tuition program at June 30, 2003 were $343,593,297. However, the program is operating at a current fund deficit of almost $53.8 million. According to an actuarial evaluation report, the present value of the Program's assets together with the present value of expected future payments is $76.2 million less than the present value of payments expected to be made by the program. The program is addressing the deficit by adding a premium to contract prices to partially amortize the current actuarial deficit.

Accountants' Findings and Recommendations

Condensed below are the nine findings and recommendations together with the Commission's responses as presented in the audit report. There was one repeated recommendation.

Not Accepted

7. Request funding to develop and implement the Child Development Teacher Scholarship Program.

<u>Findings:</u> The Commission has not yet developed a program for administering the Child Development Teacher Scholarship Program, as mandated by statute. The Program would have assisted qualified students in pursuing teaching and professional careers in child development.

<u>Response:</u> Not Accepted. Although it is correct that the Commission has not requested State funding for this program, the Agency believes that this legislation was passed in anticipation of a federal initiative for this purpose which was never funded. In most cases, for federally funded programs, the Commission adopts the federal rules for administration of the program. Given that this federal program was not funded nor fully developed, there were no rules to adopt for its administration.

The Commission is pursuing legislation to repeal the Child Development Teacher Scholarship Act. This act, passed in 1993, has never been funded. The Commission already administers a variety of teacher incentive programs including the Illinois Future Teacher Corps Scholarship, the Special Education Teacher Tuition Waiver, the Minority Teachers of Illinois Program and the Illinois Teachers and Child Care Providers Loan Repayment Program, which assist students pursuing careers in child development. In light of the level of support already afforded by these programs, and given the lack of federal funding and the difficulty of the State's current financial circumstances, the Agency feels it is more prudent to repeal this redundant program than to request additional funding.

Partially Accepted

2. Identify key functional requirements during the planning phase of a project prior to implementation to better control the project scope. This will help prevent cost and time overruns that were encountered during the Odyssey project. Integrate the lessons learned into the systems development life cycle document to adequately plan future projects.

Findings: The Commission experienced problems with the development and implementation of its loan-based system, Odyssey.

The Commission initially selected a vendor to complete its new computer system at a cost not to exceed $14,650,000. After commencing the project, the Commission requested 29 change orders which added approximately $4.1 million to the cost. The system was not fully implemented until October 2002, well beyond the March 2001 date originally planned.

As part of any systems development life cycle, the most crucial phase is the requirements analysis phase where the functional user requirements of the system are defined to meet the users' needs.

Commission officials state the change in scope, which resulted in expanded time and cost, was due to the following:

- Data conversion requirements—the original budget was for 4,770 hours and actual hours were 14,270 ($1,195,000 additional cost);
- User acceptance testing—the original plan was to use Commission employees, but due to priority assignments, the Commission requested the contractor to supplement the available staff hours ($571,000 additional cost);
- Data warehouse added to the project ($659,000 additional cost);
- Additional enhancements ($1,191,000 additional cost).

The Commission did not completely define its needs and functional requirements of the Odyssey system prior to the execution of the contract. Data for approximately 300 accounts still remain to be converted due to the rare complexities involved with these accounts. The Commission had to develop a workaround solution, outside the Odyssey system, to keep track of collection for the remaining accounts.

Partially Accepted - concluded

The resulting product required the use of three separate consulting firms and two independent contractors to assist in maintaining the product after implementation. After implementation, the Commission paid $2.7 million to outside consultants. Three of the five contracts are set to expire June 30, 2004, but may be extended. In addition to the selected vendor, the Commission paid $7.6 million to other consultants to assist in the Odyssey implementation. With these additional costs, the Commission paid over $29 million to outside consultants to implement and maintain the Odyssey system.

Response: Partially Accepted. The Commission did define its needs and the functional requirements of the Odyssey system to the best of its knowledge given the magnitude of the project, the age of the legacy system, the condition of the data in the legacy system, and the inability to control ever changing industry standards and federal regulations. We agree that our approach to management of changes throughout the course of the effort added time and cost to the project but feel that these changes were necessary.

For those change orders resulting in additional expenditures related to data conversion, until work was underway on the project the magnitude of the data conversion challenge could not be completely sized. The RFP recognized this sizing challenge by asking for vendors to offer conversion services on a time and materials basis (rather than as a fixed price).

The augmentation of resources for user acceptance testing represented a measured consideration of both scheduling risks attendant to increased testing and the benefits accruing from the testing approach used. The rigorous testing approach ensured that the functional requirements, established by ISAC, were fully met.

The Commission's use of consulting firms and independent contractors to assist in maintaining the Odyssey system was anticipated and consistent with the Commission's Information System strategic staffing plan.

The Commission would like to note the size, scope and complexity of this project and observe that it was successfully implemented.

We agree with the recommendation offered that the Commission should integrate the lessons learned during the Odyssey implementation into its systems development life cycle process.

Accepted

1. Obtain and adequately review a copy of an independent review of computer systems maintained by third-party service providers on an annual basis.

Findings: The Commission did not obtain independent review of two externally controlled computerized systems used to service portions of its student loan portfolio. Without a review, the Commission did not have complete assurance that the information system controls necessary to prevent errors or irregularities from occurring were established and operating effectively at all times.

Of the total student loan portfolio of $2.38 billion in 2003, $1.80 billion was serviced by the six third-party service providers. The Commission did not obtain nor did it review reports (SAS 70—Report on the Internal Controls in Place and Tests of Operating Effectiveness) to determine if controls were effective for two of the six service providers who serviced approximately $958 million for the Commission during FY03.

As required by the U.S. Department of Education, each service provider must arrange to have an annual independent compliance audit. However, these audits do not address whether there were proper controls in place with respect to the service provider's computer system. Independent reviews would provide the Commission assurances regarding the security, integrity, and recovery capability of computer programs.

The Commission stated that they have implemented control procedures they believe provided reasonable assurance that the data being processed was accurate and reliable and had not been altered. On a monthly basis, the cash received is reconciled to service provider reports. The monthly principal balances and accrued interest are agreed to the totals provided by the service provider.

Response: Accepted. The Commission will work with the two identified third party service providers to obtain annual SAS 70 (internal controls) reports. If the organizations will not perform SAS 70 reviews, the Commission will work with them to obtain alternative independent reviews and tests of the information system controls.

The Commission has developed an internal process to ensure all audits are obtained in a timely manner and reviewed by the Chief Information Officer and the Internal Auditor.

3. Make the Internal Audit Department an integral part of major systems development and conduct detailed reviews of significant system development and modification projects as required by the Fiscal Control and Internal Auditing Act. Perform information systems control reviews and audits during the internal audit cycle to ensure that information technology is adequately addressed.

Findings: The Commissions' Internal Audit Department failed to perform an adequate review of the Odyssey system prior to placing the system in operation.

The Commission completed two major system development and modification projects during the audit period. In October 2002, the Commission completed its implementation of Odyssey, a loan-based system to replace its legacy account-based system. This

Accepted - continued

implementation took approximately three and one-half years. The Commission also upgraded its student loan origination and serving software in July 2002. The Internal Audit Department did not actively participate in these projects as mandated by law. In addition, information system audit activities were limited and no in-depth information systems audits had been conducted on either project. If the internal controls in the new or modified systems are not reviewed, management cannot be assured that the necessary controls are present.

The Commission stated that due to the existence of a quality assurance team, the former Director of Internal Audit believed that a review was needed only after the implementation of the system.

A strong information technology presence is required to enable the Commission to meet all of its statutorily required functions. The Information Services Division has approximately 80 full-time positions supporting a mainframe and over 500 users in facilities around the State.

Response: Accepted. The Commission is in the process of developing procedures within Information Services (IS) to require internal controls to be addressed by the business units and reviewed by Internal Audit staff prior to major systems projects moving forward within IS. This would allow for controls to be examined during the SDLC and prior to implementation of major new systems. The Commission is confident that processes can be developed to ensure adequate controls are in place in the future.

4. **Establish procedures to ensure that all claims received are properly logged and entered into the system. Procedures should include routine reconciliations between claims processed and claims received.**

Findings: The Commission did not have an effective system in place to monitor the submission of lender claims. As a result the Commission forfeited over $1.6 million in reimbursements from the federal government.

The reinsurance program with the U.S. Department of Education allows the Commission to recover 98% of the payment made to lenders when a student defaults on a guaranteed loan, depending on the loan origination date. To receive insurance from the U.S. DOE, the Commission must pay the claim to the lender within 90 days of receipt of the claim.

Lost reinsurance increased dramatically during the audit period to four times its historical amount. As a result of the untimely payments, the Commission lost $1,630,000 in reinsurance on 360 claims paid during the period from October 1, 2002 to September 18, 2003. The amount lost on each loan that lost reinsurance ranged from $203 to $105,043.

Commission management state that the claims payments were not made to the lenders within 90 days because:

- All claims were not entered into the system prior to the implementation of Odyssey. Commission staff located a number of claim files which were received but not yet entered in Odyssey.
- The matching and edit routine in Odyssey were overly strict and rejected valid claims, which required additional time to process.
- Resources were allocated to the implementation project, not leaving enough resources for claims processing.

All claims received should be date-stamped, logged and monitored to ensure they are paid timely to avoid losing reinsurance.

Response: Accepted. Although we agree that there was a loss of reinsurance on certain claims, most evident during the three months immediately following implementation of the Odyssey system, the Commission took steps necessary to contain this exposure within the same three-month period.

These actions included the creation of a special task force, which included one-on-one training of claims analysts, group meetings on procedure compliance, increased attention to data entry of existing claims, and further policy and procedural development to strengthen the internal controls. In addition, a transition in leadership for the claims operation was effectuated in February of 2003. Finally, to further mitigate the effects of the lost reinsurance on these claims, the Commission undertook a special project to aggressively collect on non-reinsured loans. Thus, a portion of the liability resulting from foregone reinsurance has been reduced as collections resulting from such loans are completely retained by ISAC (rather than shared in a large part with the U.S. Department of Education).

The Commission remains confident that the necessary internal controls are in place to ensure that claims received are properly logged and entered into the system.

5. Regularly identify idle and unused equipment and assess whether the equipment should be disposed of or transferred to the DCMS. If the equipment is still useable, DCMS may reallocate the equipment to other agencies in need of that equipment. Determine quantities needed prior to purchasing the equipment to avoid buying excess computer equipment, which is more susceptible to becoming obsolete in a shorter period of time.

Findings: The Commission had new and unused computer equipment stored in the facility. During the auditors' physical inspection of fixed assets, they noted a number of unused or idle equipment items. The historical cost and quantity of each type of equipment is as follows:

Accepted - continued

Equipment Type	Quantity	Cost

Computers	128	$ 177,878
Monitors	104	25,664
Peripherals and accessories	252	229,091
Furniture	25	15,630
Total		**$ 488,263**

More than half of the cost for the stored or idle equipment was incurred in FY98 or prior. Computer equipment becomes obsolete faster than most other types of equipment and should be purchased as needed.

Commission personnel state that the equipment is stored in the building to serve as backup in case other equipment breaks down.

Response: Accepted. It should be noted that the amount of computer equipment idle during this audit cycle was higher than normal due to the high number of vacant positions created by the Early Retirement Initiative.

The Commission will undertake a review of the identified assets, establish target inventory levels and implement appropriate procedures to ensure assets are disposed of and/or transferred in accordance with identified targets and State procedures.

6. Prepare the remaining reconciliations as soon as possible to determine if receipts were properly processed and posted in the Odyssey detail records.

Findings: With the implementation of Odyssey, the Commission did not reconcile the initial months of its monthly cash receipts in a timely manner. Five months of activity remain unreconciled.

During the audit activity, the Commission began “catching up” with the monthly cash reconciliation procedures. The auditors noted that monthly cash reconciliations were not yet completed for October 2002 through February 2003.

Commission management indicated that due to the implementation of Odyssey, reports used to prepare the monthly cash reconciliations could not be generated. Also, staff performing the reconciliations were unfamiliar with the new reporting formats generated by the new system. Thus, the Commission has developed a Reconciliation Activity Definition Report that describes its new procedures to reconcile cash receipts to the Odyssey Accounting System. These procedures were put into place in October 2003.

Response: Accepted. Although the Commission agrees that the reconciliation activities were not completed at the time of the audit, it should be noted that considerable effort and resources have been and continue to be devoted to reconciling information produced through Odyssey, ISAC’s new information system. Commission staff have underway a set of activities which would result in a comprehensive reconciliation of financial information for all of the months beginning from October 2002 and continuing through the present month. The Commission expects to be current by no later than May 1, 2004.

8. The Illinois Designated Account Purchase Program (IDAPP) should comply with the requirements of the bond indentures and prepare the year-end work in a more timely manner in order to allow sufficient time to have the audited financial statements issued prior to the due dates. (Repeated-2001)

Findings: The Illinois Designated Account Purchase Program (IDAPP) has not complied with the requirements in several bond indentures that require audited financial statements be delivered to the Trustees no later than 120 days after year-end (by October 28). The FY02 report was delivered in January 2003, and the FY03 reports were delivered in February 2004.

Response: Accepted. IDAPP agrees that we would like to comply with this requirement but also realize that due to the growing complexity of the program and the strain on human resources caused by the early retirement program, this requirement will become more difficult to comply with. All new trusts after February 1998 no longer have this requirement. For older trusts, we receive an annual waiver from all the trustees.

In addition, based on the current financial reporting process and the number of parties involved, it is unrealistic for IDAPP to assert that the audited financial statements can be available within 120 days regardless of how quickly year-end work was completed.

9. Perform a supervisory review of all GAAP package forms prior to submission to ensure that information is accurate and complete. Prioritize and appropriately allocate sufficient resources to complete both GAAP package forms and financial statements accurately and completely in a timely manner. Further, re-address policies for capitalizing various fees paid relating to student loans and determine that such policies are in accordance with generally accepted accounting principles.

Findings: Numerous changes were made to the IDAPP draft financial statements presented to the auditors resulting in discrepancies between the financial statements and the GAAP Packages submitted to the Office of the State Comptroller. Several disclosures were also omitted in the draft statements provided to the auditors.

The Commission filed its GAAP packages with the State Comptroller on schedule. However, the Commission did not reflect all the required adjustments to comply with new Governmental Accounting Standards Board (GASB) pronouncements in the draft financial statements and GAAP packages submitted. Certain amounts reflected in the GAAP package forms for the IDAPP fund were reported inaccurately. The changes needed to

Accepted - concluded

the financial statements resulted in corrections and additional disclosures requiring significant additional time to complete the audit.

During the auditors' review of GAAP package forms and financial statements, the following was noted:

- IDAPP cash flow statement did not properly categorize sources and uses of cash between operating, noncapital financing, and investing categories. Amounts were displayed inaccurately on the State Comptroller's SCO 553 forms.
- The Commission did not prepare the footnote disclosed related to IDAPP's derivative investments on a timely basis. The first draft of this note was provided to the auditors in mid-December 2003.
- The Commission inappropriately capitalized approximately $1 million in fees that should have been expensed.
- The Commission did not prepare the footnote disclosed relating to non-compliance with bond indentures.

Commission personnel stated that the growing complexity of the program coupled with the number of parties involved in the financial reporting process make it difficult to have accurate GAAP package forms and timely preparation of financial statements and related footnotes available at the time in which the GAAP package is due.

Response: Accepted. Due to the number of parties involved, GAAP report process has become quite complex. In future years, IDAPP will initiate communications with the Illinois Office of the Comptroller prior to the end of the fiscal year to ensure we have knowledge of all reporting requirements. Additionally, IDAPP will perform a final supervisory review of the GAAP package prior to submission.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, "The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts ...." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records. The Chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY02 and FY03, ISAC filed seven affidavits for emergency purchases totaling $1,167,038 as follows:

- $867,038 for computer software, personnel and equipment; and
- $300,000 for bonds to purchase student loans.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

The Agency indicated as of July 2003 that no employees were assigned to locations other than official headquarters.